Inflation in May – Pressures on merchandise prices offset by lower energy and agricultural prices

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- ***INEGI* just published its inflation report for May**
- **Headline inflation (May): -0.45%m/m (Banorte-Ixe: -0.44%m/m; consensus: -0.46%m/m)**
- **Core inflation (May): 0.21%m/m (Banorte-Ixe: 0.21%m/m; consensus: 0.22%m/m)**
- **Inflation in May was explained by pressures on merchandise prices offset by lower electricity and agricultural prices**
- **With these numbers, annual inflation is at 2.6% vs. 2.54% in previous month**
- **Local rates remain stable after a 2-day rally streak and a tamed inflation scenario**

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Consumer prices decreased 0.45%m/m in May, in line with forecasts. Core inflation was 0.21% also similar to our estimates. The main deviation from our forecast comes from: (1) A larger than expected reduction in agricultural prices (-7.4bps vs. our -6.5bps); along with (2) a larger than expected contribution of services prices (7.2bps vs. our 6.7bps), as shown in the table below.

Inflation by components in May
%monthly incidence

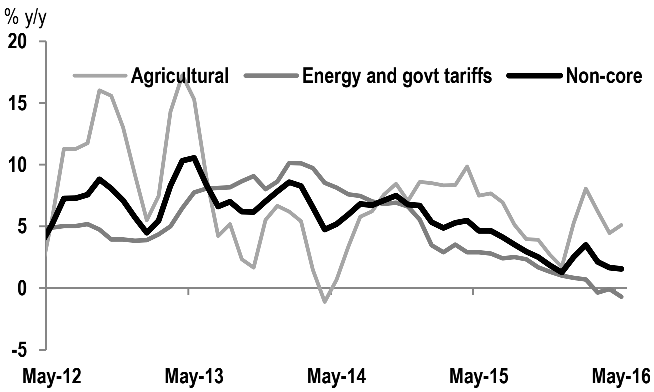
	INEGI	Banorte-Ixe	Difference
Total	-0.45	-0.44	-0.003
Core	0.16	0.16	0.002
Goods	0.09	0.09	-0.003
Processed foods	0.07	0.07	-0.004
Other goods	0.02	0.02	0.001
Services	0.07	0.07	0.005
Housing	0.03	0.03	-0.001
Education	0.00	0.00	0.000
Other services	0.03	0.03	0.005
Non-core	-0.63	-0.62	-0.004
Agriculture	-0.07	-0.07	-0.008
Fruits & vegetables	-0.10	-0.10	0.000
Meat & eggs	0.03	0.03	-0.007
Energy & government tariffs	-0.56	-0.57	0.003
Energy	-0.54	-0.54	0.003
Government tariffs	-0.03	-0.03	0.001

Source: Banorte-Ixe with data from INEGI and Banco de México.
Note: Contributions might not add due to the number of decimals allowed in the table.
Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology

Inflation in May was explained by pressures on merchandise prices offset by lower energy and agricultural prices. Merchandise prices increased 0.26% m/m on the back of increases in the prices processed foods (0.45%), and of other goods (0.1%). Meanwhile, services inflation increased 0.18% m/m as a result of housing costs up 0.19% -in particular, in homeownership costs-, coupled with a 0.05% increase in education costs and a 0.2% increase in other services prices. The *INEGI*'s report mentions the costs of restaurants (0.57%), and of other dining away from home items (0.39%), among the products with rising prices. In contrast, energy prices were down 5.38% m/m amid the start of summer discounts on electricity tariffs (-23.9%), particularly in the first half of the month. In addition, agricultural prices edged down 0.77% m/m with products such as red tomatoes (-17.4%), eggs (-3.6%), lemons (-9.9%) and onions (-8.1%), among others. These increases more than offset for the strong increases in the price of poultry (2.6%), *Husk* tomatoes (19.6%), avocadoes (21.3%) and oranges (25.6%). Finally, government tariffs came down 0.54% m/m as a result of the discounts in the price of subway and city bus transportation, particularly in Mexico City during the environmental contingency.

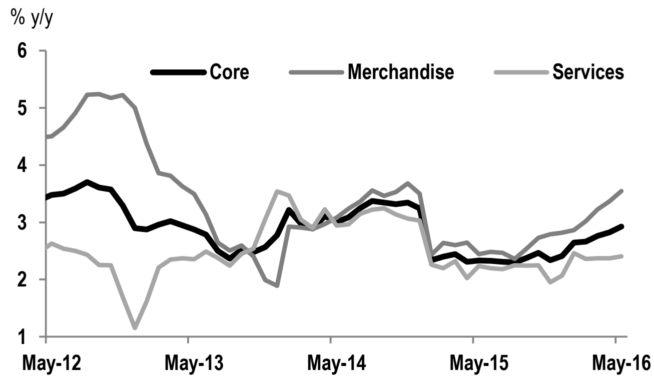
With these data, annual inflation is at 2.6% vs. 2.54% in the previous month. Meanwhile, core inflation edged up to 2.93% from 2.83% in April. The downward trend in energy prices (see chart below left) and the cycle of low prices in agricultural prices have offset the pressures observed in the core index, where we can see a moderate pass-through from exchange rate to prices. We highlight that merchandise inflation passed from 2.8% at the end of last year to 3.6% in May, while services prices have increased from 2% to 2.4% (see chart below on the right). Looking ahead, we expect inflation to continue rising to levels around 2.8% in the coming months.

Non-core inflation



Source: Banorte-Ixe with data from INEGI

Core inflation



Source: Banorte-Ixe with data from INEGI

From our fixed income and FX strategy team

Local rates remain stable after a 2-day rally streak and a tamed inflation scenario. Mexican securities are relatively stable following today's CPI report, with modest 1-2bps gains, following 2 consecutive days of a strong rally of nearly 12-17bps rally, mainly in the mid- and long-ends. Inflation dynamics continue to be supportive for local rates, especially Mbonos. In terms of strategy, we hold a positive view on 10- and 20-year Mbonos, especially securities with maturities on Dec'24, Mar'26 and May'31, even after the recent rally. For further details, please refer to the trade ideas section of our "*Fixed-Income and FX Weekly*" <pdf>, released last Monday. In terms of CPI-linked Udibonos, we expect them to start gaining appeal during the summer among investors, taking into account an attractive valuation (*e.g.* low levels of breakevens) and potentially stronger carry gains in the 2H16.

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